No. 15781

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

ELIAS MILLER, PAUL MILLER, ANNA MILLER and HELEN MILLER, and ELIAS MILLER and PAUL MILLER, as Executors of the Estate of George Miller, Deceased,

Appellants,

vs.

IRVING SULMEYER, Trustee in Bankruptcy of the Estate of DELCON CORPORATION, Bankrupt,

Appellee.

Appeal From the United States District Court for the Southern District of California, Central Division.

REPLY BRIEF OF APPELLEE.

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REPLY BRIEF OF APPELLEE.

Jurisdiction.

The Court has jurisdiction of this appeal under Section 24 of the Bankruptcy Act (11 U. S. C., Sec. 47.) While the order appealed from is still interlocutory,[1] nevertheless the questions here presented arise out of a "proceeding in bankruptcy," *i.e.,* an objection filed by Appellee-Trustee in Bankruptcy to Appellants' claim. Section 24 of the Bankruptcy Act confers appellate jurisdiction over interlocutory orders in such cases. See, *e.g., In re Greenstreet, Inc.,* 209 F. 2d 660 (C. A. 7, 1954).

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[1]In the order appealed from, the District Judge remanded the case to the Referee in Bankruptcy for the sole purpose of determining whether Appellants were entitled to certain credits against the judgment in favor of Appellee. [Transcript of Record, pp. 68-69.]

Statement of the Case.

Delcon Corporation was adjudicated a bankrupt on March 16, 1955 [Tr. p. 7][2] upon an involuntary petition filed February 23, 1955. [Tr. pp. 3-5.] Following a general reference of the proceedings to Referee in Bankruptcy Benno M. Brink [Tr. p. 6], Appellee was appointed Trustee on April 25, 1955. [Tr. pp. 7-8.]

On October 24, 1955, Appellants filed their proof of claim against the bankrupt estate in the sum of $141,742.50, the claim being assigned number 68 on the Referee's docket.[3] The claim, for the most part, represented the balance owing on the purchase price of a machine shop business sold by the Appellants to the bankrupt in 1954. In calculating the amount still owing, a credit was allowed for the net sum realized by Appellants from the sale of certain machinery and equipment repossessed by them under a chattel mortgage which had partially secured the purchase price. [Tr. pp. 8-16.]

Appellee objected to claim number 68 on the ground that the chattel mortgage was invalid in bankruptcy, that the repossession of the machinery and equipment therefore constituted a voidable transfer, and that accordingly, under Section 57g of the Bankruptcy Act, 11 U. S. C. Sec. 93g, Appellants' claim was not entitled to allowance until the subject matter of the transfer was surrendered to the Trustee. Additionally, Appellee sought affirmative relief against Appellants by way of counterclaim, on three theories: First, that the chattel mortgage, which had

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[2]All citations to the record refer to the printed Transcript of Record on file in the Court of Appeals.

[3]The claim was filed in the name of Appellant Paul Miller. But it was stipulated that in filing the claim in this manner, Paul Miller acted as agent for all of the Appellants. [See Tr. p. 32.]

been tardily recorded, was invalid as against a trustee in bankruptcy under Section 2957 of the California Civil Code and Section 70e of the Bankruptcy Act, 11 U. S. C. Sec. 110e, and that Appellee accordingly was entitled to the fair value of the property repossessed, to-wit, $82,500.00; second, that the mortgage also was invalid as against the Trustee under Section 70c of the Bankruptcy Act, 11 U. S. C. Sec. 110c; and third, that by virtue of the same facts, the repossession of the machinery and equipment constituted a voidable preference under Section 60 of the Act, 11 U. S. C. Sec. 96. [Tr. pp. 16-20.]

After trial of the issues thus raised by Appellee's Objection to Claim and Counterclaims, the Referee found and ruled on May 6, 1957, that under the applicable California statute, Civil Code Section 2957, the delay in recordation rendered the chattel mortgage void only as to creditors who held claims arising prior to recordation, and that Appellee was limited in his recovery under Section 70e of the Bankruptcy Act to the amount of the claims of those creditors who, outside of bankruptcy, could have invalidated the mortgage. Since Appellee had established that provable claims totaling $8,906.95 arose prior to recordation, judgment was entered in this sum against Appellants. The Referee further held as a matter of law that Appellee had no cause of action under Sections 70c and 60 of the Bankruptcy Act. Appellants' claim number 68 was disallowed until such time as they paid to the trustee the judgment above referred to. [Tr. pp. 53-59.]

Appellee filed a timely petition to review the Referee's judgment, contending that the Trustee's recovery should have been the sum of $82,500.00. [Tr. pp. 60-62.] Ap-

pellants did not seek a review; on the contrary, they urged the correctness of the Referee's holding.

On July 30, 1957, United States District Judge Ben Harrison reversed the Referee's decision. The Judge concluded that the mortgage was invalid in its entirety as against the Trustee under Section 70e of the Act; that under this section, as interpreted in *Moore v. Bay,* 284 U. S. 4, Appellee was not limited in his recovery to the amount of the creditors' claims on which he relied in assailing the mortgage. Judgment was directed to be entered for $82,500.00, plus interest; the case was remanded to the Referee for the sole purpose of determining whether Appellants should be given a credit against the judgment for certain expenses incurred in connection with the repossession and sale of the chattel mortgaged property.[4] [Tr. pp. 63-70.] In view of this holding, it was unnecessary for the Judge to pass upon Appellee's counterclaims under Sections 70c and 60 of the Bankruptcy Act.

On August 12, 1957, Appellants filed their Notice of Appeal from Judge Harrison's Order of July 30, 1957. [Tr. pp. 70-72.] In their "Statement of Points" on appeal, they again urged in effect that the Referee's judgment was correct and that the District Judge had erred in the order of reversal. [Tr. pp. 76-79.] This is pointed out because in Appellants' Opening Brief, they now apparently contend for the first time that both the Referee and the District Judge erred, and that Appellee is not entitled to judgment in any amount. (See, *e.g.,* Op. Br. pp. 19-22.)

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[4]Appellants allegedly incurred costs and expenses of $14,019.32 in repossessing and selling the machinery and equipment under the chattel mortgage. [See Tr. p. 34.]

Statement of Facts.

The facts involved are not in dispute, the Referee's findings being adopted *verbatim* by the District Judge: On June 1, 1954, Miller Engineering Co., a partnership composed of Appellants Paul Miller, Elias Miller, George Miller and their respective wives, sold to the bankrupt a machine shop business for $200,000.00. As part of the purchase price, the bankrupt issued a note in favor of Miller Engineering Co., securing it with a chattel mortgage upon the machine shop's physical assets. [Tr. pp. 64-65.]

The chattel mortgage was executed by the bankrupt and delivered to a representative of Miller Engineering Co. on June 1, 1954. But due to the neglect of one of the partnership's employees, the mortgage was not recorded until 79 days later on August 19, 1954. [Tr. p. 65.]

This delay in recordation, as both the Referee in Bankruptcy and District Judge correctly concluded, rendered the chattel mortgage invalid as to creditors of the bankrupt who extended credit prior to the recordation date. [Tr. pp. 67, 57; Cal. Civ. Code Sec. 2957.] On the date of bankruptcy, there were several such creditors in existence having provable claims totaling $8,906.95. [Tr. p. 66.]

On December 27, 1954, within the four month period preceding the bankruptcy, Miller Engineering Co. repossessed the property subject to the chattel mortgage, the bankrupt then being in default upon its obligation for which the mortgage was security. Thereafter in March 1955, subsequent to the filing of the bankruptcy petition, Miller Engineering Co. sold the repossessed

assets to a bona fide purchaser for the sum of $82,500.00, an amount found to represent the fair value of the property. At the time of the repossession the bankrupt was insolvent within the meaning of the Bankruptcy Act, and this fact was known to Miller Engineering Co. [Tr. pp. 65-66.]

Statutes Involved.

California Civil Code, Section 2957:

> "A mortgage of personal property . . . is void as against creditors of the mortgagor and subsequent purchasers and encumbrancers of the property in good faith and for value, unless
>
> . . . . . .
>
> "4. The mortgage, if of personal property other than crops growing or to be grown or animate personal property, is recorded in the office of the recorder of the county where the property mortgaged is located at the time the mortgage is executed. . . ."

Bankruptcy Act, Section 70e(1), 11 U. S. C., Section 110e(1):

> "A transfer made or suffered or obligation incurred by a debtor adjudged a bankrupt under this Act which, under any Federal or State law applicable thereto, is fraudulent as against or voidable for any other reason by any creditor of the debtor, having a claim provable under this Act, shall be null and void as against the trustee of such debtor."

Bankruptcy Act, Section 70c, 11 U. S. C., Section 110c:

> "The trustee, as to all property, whether or not coming into possession or control of the court, upon

which a creditor of the bankrupt could have obtained a lien by legal or equitable proceedings at the date of bankruptcy, shall be deemed vested as of such date with all the rights, remedies, and powers of a creditor then holding a lien thereon by such proceedings, whether or not such a creditor actually exists."

Bankruptcy Act, Section 60, 11 U. S. C., Section 96:

"(a)(1) A preference is a transfer, as defined in this Act, of any of the property of a debtor to or for the benefit of a creditor for or on account of an antecedent debt, made or suffered by such debtor while insolvent and within four months before the filing by or against him of the petition initiating a proceeding under this Act, the effect of which transfer will be to enable such creditor to obtain a greater percentage of his debt than some other creditor of the same class.

. . . . . .

"(b) Any such preference may be avoided by the trustee if the creditor receiving it or to be benefited thereby or his agent acting with reference thereto has, at the time when the transfer is made, reasonable cause to believe that the debtor is insolvent."

Issues Presented.

The only issues properly presented on this appeal are as follows:

1. When a chattel mortgage is invalid under state law as against some of the bankrupt's creditors, can the Trustee in Bankruptcy set aside and avoid the mortgage in its entirety, or is he limited in his recovery to the

amount of the claims of the creditors who could attack the mortgage outside of bankruptcy?[5]

2. Does the Federal Constitution prohibit the rule of bankruptcy law which enables a Trustee in Bankruptcy to invalidate in its entirety a chattel mortgage which is only partially invalid under state law?

Other purported issues set forth in the Opening Brief are either not actually in dispute or are not properly raised by the present record because of Appellants' failure to specify them in their "Statement of Points Relied on Appeal."

Outline of Argument.

I.

The Chattel Mortgage in Question Was Void in Its Entirety as Against the Trustee in Bankruptcy Under Section 70e of the Bankruptcy Act, and the District Judge Accordingly Was Correct in Rendering Judgment in Appellee's Favor for $82,500.00, the Fair Value of the Property Repossessed by Appellants.

A. *The chattel mortgage, being invalid under California law as against certain of the bankrupt's creditors, was entirely void as against the Trustee in Bankruptcy under Section 70e of the Bankruptcy Act as interpreted in Moore v. Bay, 284 U. S. 4 (1931).*

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[5]The District Judge held that a chattel mortgage partially voidable under state law by creditors of the bankrupt could be invalidated *in toto* by the Trustee under Section 70e of the Bankruptcy Act. The holding can also be supported in this case under Sections 70c and 60 of the Act, as will be argued hereinafter.

B. *Section 60 of the Bankruptcy Act does not affect nor modify the Trustee's power to avoid transfers under Section 70e of the Act.*

C. *Section 70e of the Bankruptcy Act, as interpreted in Moore v. Bay, is constitutional.*

II.

The Trustee's Power Under Section 70c of the Bankruptcy Act to Invalidate a Tardily Recorded Chattel Mortgage Would Also Support the Order of the District Judge.

III.

The Trustee's Power to Avoid Preferences Under Section 60 of the Bankruptcy Act Would Also Support the Order of the District Judge.

IV.

Purported Issues Referred to in Appellants' Opening Brief Which Are Not Properly Before the Court of Appeals on the Present Record.

A. *Appellants cannot raise for the first time on appeal issues which they failed to assert both before the District Judge and in their Statement of Points on Appeal.*

B. *Appellants' 79 day delay in recording the chattel mortgage was not excusable under the circumstances of this case.*

C. *A purchase money chattel mortgage is not exempted from the recordation requirement of Section 2957 of the California Civil Code.*

D. *Appellants' repossession of the chattel mortgaged property shortly before bankruptcy did not affect the Trustee's power to set aside the transfer, or recover the fair value thereof, under the avoiding sections of the Bankruptcy Act.*

ARGUMENT.

I.

The Chattel Mortgage in Question Was Void in Its Entirety as Against the Trustee in Bankruptcy Under Section 70e of the Bankruptcy Act, and the District Judge Accordingly Was Correct in Rendering Judgment in Appellee's Favor for $82,500.00, the Fair Value of the Property Repossessed by Appellants.

A. The Chattel Mortgage, Being Invalid Under California Law as Against Certain of the Bankrupt's Creditors, Was Entirely Void as Against the Trustee in Bankruptcy Under Section 70e of the Bankruptcy Act as Interpreted in Moore v. Bay, 284 U. S. 4 (1931).

Appellants' delay of 79 days in recording their chattel mortgage rendered it invalid under Section 2957 of the California Civil Code as against creditors whose claims arose prior to recordation. Both the Referee and the District Judge so found and held; indeed, the correctness of this determination was conceded by Appellants until for the first time in their Opening Brief they appear to dispute it. The controversy in the courts below merely concerned the extent of the Trustee's recovery, namely, whether judgment should be entered against Appellants for $8,906.95, the amount of the creditors' claims arising prior to recordation, or whether the Trustee was entitled to invalidate the chattel mortgage *in toto* and recover $82,500.00, the full value of the property subject thereto. Appellee will argue in this portion of his brief the question of the extent of the Trustee's recovery under Section 70e of the Bankruptcy Act, as interpreted in *Moore v. Bay*. Appellants' present contention that the chattel mortgage was completely valid under state law will be refuted under heading IV of this brief, *infra*.

In 1931, in *Moore v. Bay,* 284 U. S. 4, the United States Supreme Court established by unanimous opinion two fundamental principles of bankruptcy law:

First, that when under state law a transfer is voidable to any extent by a creditor of the bankrupt having a provable claim, the transfer is entirely void as to the Trustee in Bankruptcy. That is to say, the extent of the Trustee's recovery is not limited to the amount of the claims upon which he relies in attacking the transfer.

Second, that the recovery thus made by the Trustee, is to be distributed pro rata to all creditors of the bankrupt, in accordance with the distributive provisions of the Bankruptcy Act, and not only to those creditors who might have attacked the transfer outside of bankruptcy.

While the Supreme Court's decision was rendered in the characteristically brief style of Mr. Justice Holmes, analysis of the opinion of the Ninth Circuit, *In re Sassard & Kimball,* 45 F. 2d 449 (C. A. 9, 1930), which was reversed *sub nom. Moore v. Bay,* leaves no doubt that the holding established both the foregoing propositions.

The case involved a chattel mortgage which, because of a failure to record the notice required by Section 3440 of the California Civil Code, was invalid as to certain creditors of the bankrupt but valid as to others. The Trustee asserted that the mortgage in question was completely void as to him:

> "It is the contention of appellant [Trustee] that, under Section 70e of the Bankruptcy Act . . ., the mortgage in question, being void as to one creditor or class of creditors, is void in toto at the suit of the trustee." (45 F. 2d at 450.)

The Court of Appeals rejected this contention, holding that the Trustee had no greater rights than the creditors who could attack the mortgage under state law:

> "There is no express language in this section [70e] which specifically gives to any unsecured creditor of a bankrupt any greater rights or any secured creditor any less right than he had before adjudication in bankruptcy. The rights of a trustee in bankruptcy to 'avoid any transfer' are no greater than those of a creditor or particular class of creditors. It is clear, we think, that a trustee in bankruptcy is limited in his control and disposition of the estate of the bankrupt to the rights of creditors as such rights existed and could be enforced under the state law prior to the time proceedings in bankruptcy were instituted." (45 F. 2d at 450.)

The Supreme Court reversed this decision. It therefore necessarily held that the Trustee did derive greater rights than the creditors upon whom he relied; that the Trustee's power was to invalidate the transfer in its entirety even though the creditors whose claims were relied upon could have invalidated the transfer only in part outside of bankruptcy.

Since 1931, there has not been a single Court of Appeals or Federal District Court which has denied the rule that a transfer, voidable in part by creditors of the bankrupt, is completely void under Section 70e of the Bankruptcy Act as against the Trustee in Bankruptcy. Thus, the Second Circuit stated in *City of New York v. Rassner,* 127 F. 2d 703, 707 (C. A. 2, 1942):

> ". . . in many cases chattel mortgages are valid as against some creditors and not others; and yet ever since Moore v. Bay, 284 U. S. 4, 52 S. Ct. 3,

76 L. Ed. 133, 76 A. L. R. 1198, it has been considered proper to invalidate a mortgage in toto even though the only creditor entitled to invalidate has an insignificant claim, and proper to distribute the proceeds among all the creditors."

The Fourth Circuit in *Friedman v. Sterling Refrigerator Co.,* 104 F. 2d 837, 840 (C. A. 4, 1939), held:

". . . it is held that a claim which for want of record is void as against some but not all of the creditors of the bankrupt may be avoided in toto by the trustee in bankruptcy, even though creditors generally benefit by the avoidance." (Trustee relied upon a provable claim of $14.23 to set aside a security transaction involving more than $500.00.)

Likewise, the Fifth Circuit has held in *Corley v. Cozart,* 115 F. 2d 119, 121 (C. A. 5, 1940):

"The bill of sale to secure debt, being admittedly invalid as against subsequent creditors without notice, was properly held to be invalid in its entirety on objection of the Trustee in Bankruptcy. A claim void against some of the creditors of a bankrupt may be avoided in its entirety by the Trustee even though creditors generally benefit by the avoidance."

General Motors Acceptance Corporation v. Coller, 106 F. 2d 584 (C. A. 6, 1939), *cert. den.* 309 U. S. 682, involved a tardily recorded chattel mortgage, which, under the applicable Michigan statute, was invalid as to creditors who extended credit in the interim between execution of the mortgage and its recordation. At page 586, the Sixth Circuit held on rehearing:

". . . Moore v. Bay . . . requires a holding that the mortgages are void in their entirety regardless of the extent of interim credit."

In *American Trust Co. v. New York Credit Men's Adjust. B.,* 207 F. 2d 685, 689 (C. A. 2, 1953), the court said:

> "Appellant urges that the delay [in recordation of the chattel mortgage] should not prejudice its claim as against those who became creditors after filing; but the contention is without merit. As we have recently held, Zamore v. Goldblatt, 2 Cir., 194 F. 2d 933, certiorari denied Goldblatt v. Zamore, 343 U. S. 979, 72 S. Ct. 1077, 96 L. Ed. 1370, where one creditor represented by the trustee can avoid the mortgage, so may the trustee on behalf of all. Bankruptcy Act, §70, sub. e(1), 11 U. S. C. A. §110, sub. e(1); Moore v. Bay, 284 U. S. 4, 52 S. Ct. 3, 76 L. Ed. 133. The . . . mortgages are therefore void."

The Court of Appeals for the Eighth Circuit followed the same rule in *Mercantile Trust Co. v. Kahn,* 203 F. 2d 449 (C. A. 8, 1953), where the Trustee relied upon creditors with approximately $200 of claims to invalidate *in toto* a chattel mortgage upon property having a value of about $1700.

Accord:

Zamore v. Goldblatt, 194 F. 2d 933 (C. A. 2, 1952), *cert. den.* 343 U. S. 979;

Trailmobile, Inc. v. Wiseman, 244 F. 2d 76 (C. A. 6, 1957);

In re Tobias, 150 Fed. Supp. 288 (W. D. Mich., 1957);

In re Higgs, 126 Fed. Supp. 16 (E. D. Mich., 1954);

Deane v. Fidelity Corporation of Michigan, 82 Fed. Supp. 710 (W. D. Mich., 1949);

In re Independent Distillers of Kentucky, 34 Fed. Supp. 708 (W. D. Ky., 1940);

In re Johnson, 23 Fed. Supp. 337 (W. D. Mich., 1938);

In re Consolidated Oil Company, 140 Fed. Supp. 614 (E. D. Mich., 1956);

Tatelbaum v. Nat'l Store Etc. Co., 196 Md. 599, 78 A. 2d 228 (Ct. of App. Md., 1951).

The present state of the law is excellently summarized in 4 Collier on Bankruptcy, Par. 70.95, at pages 1533-1536:

> "Since the decision in the *Bay* case, no dissenting voice has been raised by the courts. The accepted rule is that in a suit under §70e if the transfer or obligation is voidable at all, it is voidable *in toto.* Thus where a chattel mortgage, because it was not filed promptly after its execution, is void as against creditors who extended credit to the bankrupt during the interim, it is void as against the trustee in its entirety, regardless of the extent of such interim credit. . . . There can be no doubt that the Supreme Court ruled authoritatively on the matter, for the issue was squarely before the court. It has been said that the language of the decision indicates that the problems of distribution and measure of recovery were confused by the Court, and that the Court intended to rule only as to distribution. However, the demarcation between the two problems in various fact situations is not often clearly discernible. It is more probable, then, that the Court pursued a conscious course, particularly since the issue had been definitely raised. . . .
>
> "In support of the [*Moore v. Bay*] rule of complete avoidance, it can be argued that although the

trustee's power of avoidance under §70e is predicated upon that of creditors granted by applicable state or federal law, the Bankruptcy Act itself governs the extent and distribution of recovery. In this connection attention must again be called to certain language inserted in §70e(2) by the 1938 Act:

" 'All property of the debtor affected by any such transfer shall be and remain a part of his assets and estate, discharged and released from such transfer and shall pass to, and every such transfer or obligation shall be avoided by, the trustee for the benefit of the estate.'

"Once it has been determined that a particular transfer or obligation is voidable by the trustee, it would seem that this provision compels an avoidance *in toto,* assuming, as we must, that such language was not inserted in the Act without purpose. At the very least it certainly indicates no intention of restricting or revoking the rule of *Moore v. Bay,* and thus gives the rule tacit approval. In fact, one outstanding authority has stated that the rule was called to the attention of the draftsmen of the 1938 Act, and was considered by them. Consequently, irrespective of possible criticism on the basis of inequity, the rule of *Moore v. Bay* must be regarded as absolutely controlling."

Other commentators have similarly stated the *Moore v. Bay* principle.

See, *e.g.,*

1 Glenn, *Fraudulent Conveyances and Preferences,* (Rev. ed. 1940), pp. 567-568;

Schwartz, *Moore v. Bay: Should Its Rule be Abolished?* 29 J. Nat'l Assoc. of Referees in Bankruptcy, No. 2 (April, 1955).

The case of *In re Consorto Const. Co.*, 212 F. 2d 676 (C. A. 3, 1954), cited by Appellants (Op. Br. p. 18), is not in point. It turns on the applicable Pennsylvania law which, unlike California's statute, prevents a creditor from attacking a chattel mortgage once it has been recorded, even though the claim arose before recordation. The *Consorto* decision is discussed more fully under heading II of this Brief, *infra.*

Appellants completely miss the point when they argue that their chattel mortgage was valid under California law as against creditors coming into existence after the delayed recordation. (See, *e.g.,* Op. Br. pp. 15-18, 22-23.) The question here is whether it was valid at all as against a Trustee in Bankruptcy who, by virtue of the Bankruptcy Act, occupies a unique position.

In view of the foregoing authorities, it is clear that the District Judge correctly held Appellants' chattel mortgage void *in toto* as against Appellee under Section 70e. Since Appellants had repossessed and sold the mortgaged property to a bona fide purchaser, and could no longer return the assets in kind, it followed that Appellee was entitled to a money judgment for $82,500.00, the fair value of the property involved. It also follows, of course, that upon payment of the judgment Appellants will have the right under Section 57n of the Bankruptcy Act, 11 U. S. C., Sec. 93n, to file a claim for the full amount then owing to them, and to share pro rata with other creditors in the dividends paid by the bankruptcy estate.

B. Section 60 of the Bankruptcy Act Does Not Affect nor Modify the Trustee's Power to Avoid Transfers Under Section 70e of the Act.

In their Statement of Points on Appeal, Appellants suggest that the Trustee's avoiding powers under Section 70e of the Bankruptcy Act, as interpreted in *Moore v. Bay,* are in some way modified and made less effective by Section 60 of the Act. [Tr. pp. 76-79.] Perhaps this contention has now been abandoned, although a passing reference is made to it in the introductory portion of the Opening Brief. (Op. Br. p. 12.)

In any event, no authority is cited to support the point, and none could be. A trustee in bankruptcy is armed with a number of powers to strike down or recover various types of liens and transfers. Thus, he can recover certain preferences under Section 60 of the Bankruptcy Act, 11 U. S. C., Sec. 96; invalidate certain judicial liens under Section 67a, 11 U. S. C., Sec. 107a, and certain statutory liens under Section 67c, 11 U. S. C., Sec. 107c; invalidate fraudulent transfers under Section 67d, 11 U. S. C., Sec. 107d; invoke all the rights and remedies of a lien creditor under Section 70c, 11 U. S. C., Sec. 110c; and set aside any transfers voidable by a creditor under state law, under Section 70e, 11 U. S. C., Sec. 110e. These avoiding powers are cumulative. So far as can be ascertained, it has never been urged until the present time, that the sections modify each other or should be read *in pari materia.*

Certainly Section 60 was part of the Bankruptcy Act when *Moore v. Bay* was decided in 1931; yet without reference to it, the Supreme Court there interpreted Section 70e. No other court in following *Moore v. Bay* has ever suggested that the holding of that case was affected by the provisions of Section 60. And the legislative history of the various amendments to Section 60 enacted since 1931 reveals nothing which would support Appellants' contention.

In short, the various avoiding powers, rather than modifying each other, are intended for different purposes, although in some instances, as in the present case, more than one of the sections will enable the Trustee to make his recovery. The leading treatise on the subject of bankruptcy states the proposition as follows:

> "Another point to note is that §§60, 67a, 67d, 70c and 70e offer the trustee an arsenal of weapons. Sometimes all are ineffective; at other times only one will suffice; still another time the trustee may invoke two or more provisions, or may choose one weapon as peculiarly fitted to his task."
>
> 3 Collier on Bankruptcy, Par. 60.01, pp. 745-746.

C. Section 70e of the Bankruptcy Act, as Interpreted in Moore v. Bay, Is Constitutional.

Appellants suggest that Section 70e, as construed by the Supreme Court in *Moore v. Bay,* is of doubtful constitutionality. This point, however, while mentioned in their brief, is neither argued nor spelled out, and no authority is cited in support of it. (Op. Br. pp. 24, 14, 7-8.) Apparently, the portion of the Constitution which

Appellants have in mind is the due process clause of the Fifth Amendment.

If any doubts ever existed as to Congress' authority to give a trustee in bankruptcy the *Moore v. Bay* broad measure of recovery, they were laid to rest by Chief Justice Marshall more than a century ago in *Sturges v. Crowninshield,* 4 Wheat. 120, 192 (1819), where the legislative power in the field of bankruptcy under Article I, Section 8, clause 4 of the Constitution was held to be "both unlimited and supreme."

> "The United States Supreme Court, by a long line of decisions, has affirmed the power. Only in its 5—4 decision in *Ashton v. Cameron Co. Water Imp. Dist. No. 1* holding the Municipal Debt Readjustments Act (§§78-80) unconstitutional as an infringement of state sovereignty has it attempted to limit the bankruptcy power when reasonably exercised. But this decision, characterized by commentators as 'legally and economically indefensible', has been effectively overruled by *United States v. Bekins* which sustained the second Municipal Debt Readjustments Act. . . ."
>
> 1 Collier on Bankruptcy, Par. 0.02, pp. 5-6.

Another authoritative writer, Charles Warren, in his book *Bankruptcy in United States History* (1935), p. 9, quoted in Hanna and MacLachlan, *Creditors' Rights and Corporate Reorganization, Cases and Materials* (1957 ed.), p. 298, n. 5, discusses the Congressional power as follows:

> "The trail [of the bankruptcy clause] is strewn with a host of unsuccessful objections based on constitutional grounds against the enactment of various

provisions, all of which are now regarded as perfectly orthodox features of a bankruptcy law. Thus, it was at first contended that, constitutionally, such a law must be confined to the lines of the English statute; next, that it could not discharge prior contracts; next, that a purely voluntary law would be non-uniform and therefore unconstitutional; next, that there could be no discharge of debts of any class except traders; next, that a bankruptcy law could not apply to corporations; next, that allowance of State exemptions of property would make a bankruptcy law non-uniform; next, that any composition was unconstitutional; next, that there could be no composition without an adjudication in bankruptcy; next, that there could be no sale of mortgaged property free from the mortgage. All these objections, so hotly and frequently asserted from period to period, were overcome either by public opinion or by the Court."

The Supreme Court, in *Wright v. Union Central Ins. Co.,* 304 U. S. 502, 517 (1938), *reh. den.,* 305 U. S. 668, rejected a contention similar to Appellants' present constitutional argument, as follows:

> "If the argument is that Congress has no power to alter property rights, because the regulation of rights in property is a matter reserved to the States, it is futile. Bankruptcy proceedings constantly modify and affect the property rights established by state law. A familiar instance is the invalidation of transfers working a preference, though valid under state law when made."

These authorities, especially in light of Appellants' failure to press the point, compel the dismissal of the constitutional challenge as frivolous.

II.

The Trustee's Power Under Section 70c of the Bankruptcy Act to Invalidate a Tardily Recorded Chattel Mortgage Would Also Support the Order of the District Judge.

Although it was unnecessary for the District Judge to pass upon Appellee's counterclaim under Section 70c of the Bankruptcy Act, that section also would support the order here appealed from. Section 70c provides in part as follows:

> "The trustee, as to all property, whether or not coming into possession or control of the court, upon which a creditor of the bankrupt could have obtained a lien by legal or equitable proceedings at the date of bankruptcy, shall be deemed vested as of such date with all the rights, remedies, and powers of a creditor then holding a lien thereon by such proceedings, *whether or not such a creditor actually exists.*" (Emphasis added.)

Constance v. Harvey, 215 F. 2d 571 (C. A. 2, 1954), *cert. den.* 348 U. S. 913, involved a tardily recorded chattel mortgage. Under the applicable New York statute, as under California's, creditors whose claims arose prior to recordation could levy upon the chattel mortgaged property even after recordation. (The leading case establishing the California rule is *Ruggles v. Cannedy,* 127 Cal. 290, 298-302 (1899).) On this construction of the recording law, the Second Circuit held on rehearing that since a hypothetical creditor who extended credit prior to the delayed recordation could have levied on the chattel mortgaged property at the date of bankruptcy, the Trustee obtained a lien under Section 70c on that date. This result followed under Section 70c even though the Trustee

failed to prove, and there might not even exist, an actual creditor who could obtain such a lien at the time of bankruptcy. Obviously, the Trustee's recovery under Section 70c, not being derived from rights of actual creditors, must of necessity involve a complete invalidation of the defective chattel mortgage.

Although *Constance v. Harvey* was criticized by many commentators, the Second Circuit declined to modify its holding when the same question was presented to it for decision two years later. In *Conti v. Volper,* 229 F. 2d 317, 318 (C. A. 2, 1956), the Court, in a brief *per curiam* decision, merely quoted Section 70c and then stated:

> ". . . it is difficult to see how such plain language could be disregarded."

The Seventh Circuit in *In re Kranz Candy Co.,* 214 F. 2d 588, 591-592 (C. A. 7, 1954), independently gave Section 70c the same construction as that put upon it by the Second Circuit. And this Court cited *Constance v. Harvey* with approval in *England v. Sanderson,* 236 F. 2d 641, 643, n. 7 (C. A. 9, 1956).

No conflict exists between the holding in *Constance v. Harvey* and the decision in *In re Consorto Const. Co.,* 212 F. 2d 676 (C. A. 3, 1954), cited by Appellants. (Op. Br. p. 18.) The Pennsylvania recording statute involved in the *Consorto* case protects only creditors who actually levy on the chattel mortgaged property prior to recordation, as distinguished from the New York and California statutes which protect those extending credit prior to recordation, whether or not they obtain their liens prior thereto. Therefore, recordation having taken place in the *Consorto* case prior to bankruptcy, no hypothetical or actual creditor on that date could prevail over

the chattel mortgagee, and the Trustee accordingly could not rely on either Sections 70c or 70e. But the Third Circuit expressly distinguished the California recording statute as construed in *Ruggles v. Cannedy,* 127 Cal. 290, 298-302 (1899), indicating that a different conclusion would be required if the Pennsylvania law were similar.

Section 70c, therefore, requires a holding in the present case that the chattel mortgage was completely void as to Appellee, with the result that judgment was properly directed for the full fair value of the repossessed machinery and equipment.

III.

The Trustee's Power to Avoid Preferences Under Section 60 of the Bankruptcy Act Would Also Support the Order of the District Judge.

Appellee concedes that his argument under this heading must stand or fall on the validity of the positions taken by him in previous sections of this Brief. That is to say, the Trustee's cause of action under Section 60 of the Bankruptcy Act merely buttresses those under Sections 70e and 70c and is not independent of them.

Since, as has been demonstrated earlier, the chattel mortgage in question was void in its entirety as against the Trustee, Appellants were, in the eyes of the bankruptcy law, only unsecured or general creditors on December 27, 1954 when the repossession occurred. It is well established that a transfer of property to a creditor holding a lien voidable in bankruptcy constitutes a preference.

3 Collier on Bankruptcy, Par. 60.22, pp. 842-844, and cases there cited.

The date of repossession being within four months of bankruptcy, and the other elements of a voidable preference having been established [see Tr. p. 66], it follows that Appellee is entitled to recover the full fair value of the property repossessed under Section 60 of the Bankruptcy Act.

IV.

Purported Issues Referred to in Appellants' Opening Brief Which Are Not Properly Before the Court of Appeals on the Present Record.

A. Appellants Cannot Raise for the First Time on Appeal Issues Which They Failed to Assert Both Before the District Judge and in Their Statement of Points on Appeal.

The arguments made by Appellants, refuted hereinafter in Subsections B, C and D of this Heading IV, are raised for the first time in this Court, not having been urged either before the District Judge or in the Statement of Points on Appeal. [See Tr. pp. 76-79.] As a matter of fact, in their Statement of Points Appellants impliedly asserted that these contentions which they now make were invalid. For each of them, if valid, would result in a conclusion that Appellee should have no recovery at all; the Statement of Points, however, contends that the Referee "correctly determined" that the Trustee was entitled to a judgment for $8,906.95. [Tr. p. 77.]

Since the complete record has not been brought here,[6] Appellants cannot rely on purported issues which they

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[6]None of the evidence is contained in the present record, Appellants having chosen to omit designating the transcripts and exhibits which were before the Referee and District Judge. [See Pretrial Order, Tr. pp. 28-29.]

failed to specify in their Statement of Points. Federal Rules of Civil Procedure, Rule 75(d), provides in part as follows:

> "If the appellant does not designate for inclusion the complete record and all the proceedings and evidence in the action, he shall serve with his designation a concise statement of the points on which he intends to rely on the appeal."

The Rule therefore makes unavailable to Appellants any grounds omitted from their Statement.

E.g.,

Jesionowski v. Boston & Maine R. Co., 329 U. S. 452 (1947);

Ritchie v. Drier, 165 F. 2d 238 (C. A. D. C., 1947).

The points now sought to be raised, however, are without merit in any event, and are discussed in the following subsections of this Brief.

B. Appellants' 79-day Delay in Recording the Chattel Mortgage Was Not Excusable Under the Circumstances of This Case.

The argument that the delay of 79 days in recording the mortgage was excusable in this case (Op. Br. pp. 21-22) is wholly without foundation. In the first place, far shorter delays have been held to be fatal, apparently as a matter of law.

See, *e.g.,*

In re Hansen, 268 Fed. 904 (S. D. Cal., 1919);

In re Kessler, 90 Fed. Supp. 1012 (S. D. Cal., 1950).

Furthermore, the testimony before the Referee revealed that the dishonesty of Appellants' employee, who overlooked the recording, consisted of an embezzlement which was completely unconnected with the chattel mortgage; that the employee breached no fiduciary duty with respect to the mortgage, nor did he attempt to conceal it, but merely was guilty of neglect in not promptly placing it of record. Finally, the transcripts would show that one of the appellants testified that the excitement concerning his then planned wedding contributed to the lateness of recordation.

For these reasons, both the Referee and District Judge found and concluded that the delay was "unreasonable" [Tr. pp. 67, 57, 34]; indeed, Appellants did not even suggest the contrary until their Opening Brief in this Court. Clearly it is too late now to make such a contention.

C. A Purchase Money Chattel Mortgage Is Not Exempted From the Recordation Requirement of Section 2957 of the California Civil Code.

So far as can be ascertained, no one has ever before seriously contended that a purchase money chattel mortgage need not comply with the prompt recordation requirement of Section 2957 of the California Civil Code. The command of the section applies to all mortgages of personal property, without exception.

In *Citizens Nat. Trust & Savings Bank v. Gardner,* 161 F. 2d 530 (C. A. 9, 1947), and *In re Mercury Engineering,* 68 Fed. Supp. 376 (S. D. Cal., 1946), purchase money chattel mortgages were involved. While in both cases the relatively short delays in recordation were held excusable because of the particular facts, the

opinions make it clear that purchase money, as well as other types of chattel mortgages, must be promptly recorded under Civil Code Section 2957.

Appellants point out that Civil Code Section 3440 (now Sec. 3440.1), requiring in certain cases the filing of a 10 day notice of intention to execute a chattel mortgage, has been held inapplicable to purchase money transactions; the argument is that a similar exemption should be read into Section 2957.

The two sections, however, have different purposes. The Section 3440 notice is intended to afford creditors an opportunity to protect their rights before the debtor transfers or encumbers assets upon which the creditors may have relied in extending credit. In a purchase money transaction, where the debtor is acquiring new assets rather than disposing of old ones, the purpose of Section 3440 is not defeated by excusing the notice requirement.

Citizens Nat. Trust & Savings Bank v. Gardner, 161 F. 2d 530, 532-533 (C. A. 9, 1947).

On the other hand, one of the aims of Section 2957 is to protect creditors against secret liens on property which the debtor apparently owns outright. The danger from secret security interests is just as great in the case of purchase money chattel mortgages as in any other type, especially as to creditors who extend credit in the interim between the time the debtor takes possession of the property and the date on which recordation reveals the existence of the encumbrance. To excuse a purchase money instrument from prompt filing under Section 2957 would *pro tanto* frustrate the legislative purpose of that section. Indeed, *In re Mercury Engineering,* 68 Fed. Supp. 376 (S. D. Cal., 1946), cited and quoted by Appel-

lants (Op. Br., App. pp. 1-3), recognizes the difference in the functions of Sections 3440 and 2957 of the Civil Code.

D. Appellants' Repossession of the Chattel Mortgaged Property Shortly Before Bankruptcy Did Not Affect the Trustee's Powers to Set Aside the Transfer, or Recover the Fair Value Thereof, Under the Avoiding Sections of the Bankruptcy Act.

Appellants seem to suggest that the fact they repossessed the chattel mortgaged property prior to bankruptcy in some way improved their position or cured the defect of tardy recordation. (See Op. Br. pp. 26-28.) Whatever may be the law in other states, there is no doubt in California but that a creditor, as to whom a chattel mortgage is defective, can attack it either before or after the chattel mortgagee has taken possession. The leading case of *Noyes v. Bank of Italy,* 206 Cal. 266 (1929), established the rule that the avoiding powers of a Trustee in Bankruptcy, in California at least, are not affected by the repossession of the property prior to bankruptcy. The California Supreme Court there held, 206 Cal. at 270:

> "Even if it be assumed that a mortgage void as to creditors pursuant to the plain terms of the statute could be transformed into a valid mortgage by the mortgagee seizing the mortgaged property or by otherwise taking possession of the same with the consent of the mortgagor and thus shut out general creditors or creditors not possessing a lien or armed with process, yet we are satisfied that it was the intention of the Bankruptcy Act to safeguard the rights of such general creditors by giving the trustee the status of a lien creditor and also to prevent the

mortgagee from defeating the rights of the creditors of the bankrupt by contending that such creditors were general creditors only. It seems reasonable to conclude, also, that the purpose of the Bankruptcy Act investing power in the trustee to attack a chattel mortgage void under the statute was to render ineffectual as to creditors the act of the mortgagee in taking possession of the property before the commencement of the bankruptcy proceedings. In other words, the trustee was intended to be placed in the position of a lien creditor who would, but for the bankruptcy proceeding, be entitled to attack the alleged void mortgage and to enable him to protect the interests of general creditors against invalid liens, unlawful transfers, etc."

Conclusion.

For the foregoing reasons, the Order of the Hon. Ben Harrison, United States District Judge, dated July 30, 1957, should be affirmed.

Respectfully submitted,

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